

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Knox Analyst: Marion Mann DeJong Bill Number: AB 2766
Related Bills: See Legislative History Telephone: 845-6979 Introduced Date: 02/25/2000
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Donations of Real Property to City or County Credit

SUMMARY

This bill would allow taxpayers a credit equal to 20% of the assessed value of real property donated to a city or county for open-space purposes.

EFFECTIVE DATE

As a tax levy, this bill would become effective immediately and would apply to taxable or income years beginning on or after January 1, 2000.

LEGISLATIVE HISTORY

SB 680 (1999), AB 841 (1999), SB 87 (1997/98), SB 2080 (1997/98) and SB 1280 (1995/96) would have established the California Land and Water Conservation Act within the Public Resources Code. In addition, these bills would have allowed a tax credit to taxpayers who contributed property to the state, approved local governments, or approved nonprofit organizations designated by the state or local government. SB 680 is being held under submission in the Assembly Appropriations Committee. The other four bills died in committee.

BACKGROUND

The Resource Conservation Division of the California Public Resources Code (PRC) provides for expending state, county, city, district, or other public funds for projects that will save the soil, water, air, and basic resources of the state from unreasonable and economically preventable waste and destruction. The PRC provides the directors of resource conservation districts authority to acquire property through purchase, lease, contract, or gift. Various special funds and general obligation bonds fund land acquisitions.

The California Endangered Species Act, enacted in 1984, outlines the state's policy to conserve, protect, restore, and enhance any endangered species or any threatened species and its habitat. The legislation stated the intent to acquire lands for habitat for these species. Additionally, the act states that all state agencies, boards, and commissions shall seek to conserve endangered species and threatened species and shall use their authority to further the purposes of the act.

Board Position:

_____ S	_____ NA	_____ NP
_____ SA	_____ O	_____ NAR
_____ N	_____ OUA	_____ <u>X</u> PENDING

Department Director

Date

Alan Hunter for GHG

3/29/00

Voters adopted the California Wildlife Protection Act of 1990. This act states that because wildlife and fisheries conservation is in the public interest, it is necessary to keep certain lands in open space and natural condition to protect significant environmental values of wildlife and native plant habitat, riparian and wetland areas, native oak woodlands, and other open-space lands. The funding to accomplish these goals is provided through the continuously appropriated Habitat Conservation Fund. Money is transferred into this fund from various sources, such as the Cigarette and Tobacco Products Surtax Fund, the California Environmental License Plate Fund, and the Fish and Game Preservation Fund. If the annual amount transferred from these funds does not equal \$30 million, the difference is transferred from the General Fund. All state officials are required to implement the act to the fullest extent of their authority.

The Governor's budget for 2000-01 includes a one-time personal income and bank and corporation tax credit in 2000 for land donated for conservation purposes.

SPECIFIC FINDINGS

Current federal and state tax laws provide various tax credits designed to provide tax relief for taxpayers that incur certain expenses (e.g., child and dependent care credits) or to influence business practices and decisions or achieve social goals. Credits generally are based on a percentage of expenditures by the taxpayer. Currently, no existing federal and state laws provide income tax credits for the contribution of property to state or local governments.

Under **current federal and state laws**, contributions of property qualify as charitable contributions if the property is contributed to or for the use of qualified organizations (public, private or governmental), as follows:

- ⌚ For corporations, **existing federal and state laws** allow a deduction for charitable contributions, limited to 10% of the taxpayer's net income (except as specified). Contributions in excess of 10% may be carried over to the following five succeeding income years. Under **state law**, the amount of a contribution is limited to a taxpayer's basis in the property contributed.
- ⌚ For individuals, both **federal and state laws** allow a deduction for charitable contributions. The amount generally deductible for a contribution of appreciated real property (normally capital gain property) is equal to the fair market value (FMV) of the property on the date of contribution. For contributions to certain types of charitable organizations, including governmental units, the allowable deduction is limited to 50% of the taxpayer's adjusted gross income (AGI). However, for other types of charitable organizations, the deduction may be limited to 30% of the taxpayer's AGI. If the charitable contribution amount exceeds 50% (or 30%) of the taxpayer's AGI, the taxpayer may carry over the excess amount up to five years.

Generally, **under current federal and state laws**, a taxpayer is denied a charitable contribution deduction for gifts to charity for the rent-free use of property and other non-trust gifts where less than the taxpayer's entire interest in the property is contributed, except in the following cases:

- Ⓟ A contribution of an undivided portion of a taxpayer's entire interest in property (e.g., a one-fourth interest in property);
- Ⓟ A contribution of a remainder interest in a personal residence or farm;
- Ⓟ A qualified conservation contribution; and
- Ⓟ A charitable deduction would have been allowed had the interest been transferred in trust.

Under current federal and state laws, the amount deductible for charitable contributions of appreciated property depends on whether it is ordinary income property (i.e., depreciable real or tangible personal property used in a trade or business) or capital gain property, or a combination of both. The deduction for ordinary income property is limited to the FMV of the property less the amount that would be ordinary income had the donor sold the property for its FMV. Generally, gifts of capital gain property are deductible at their FMV at the date of contribution.

California law generally conforms to federal law relating to gain or loss on the disposition of capital assets. **Federal and state law** provide that capital assets are property other than: stock in trade or other inventory-type property held primarily for sale to customers; depreciable tangible personal or real property used in a trade or business (i.e., "Section 1231 Property"); copyrights and other literary property; accounts or notes receivable acquired in the ordinary course of business; and U.S. government publications, as specified.

Generally, capital gain is realized when a capital asset is sold or exchanged and the amount realized exceeds the adjusted basis of the asset (and, in certain situations, the amount subject to recapture under federal law). Adjusted basis in a capital asset is generally determined by the costs of the asset (when capital assets are acquired in certain non-recognition transactions, adjusted basis may be a carryover or substituted basis) and is increased by further investment or decreased by allowable deductions (such as depreciation). Capital losses occur when a capital asset is sold or exchanged and the amount realized is less than the adjusted basis of the asset. Generally a gain or loss from the sale or other disposition of property that does not qualify as a capital asset is ordinary gain or loss (other than gain from the sale of Section 1231 property), and similarly, a sale or other disposition of a capital asset in a transaction that does not qualify as a "sale or exchange" also generates ordinary income.

Under recent amendments to **federal law**, the maximum tax rate applicable to net capital gains for assets held more than one year was reduced from a maximum rate of 28% to 20% and to 10% for individuals, estates, and trusts who would pay tax at the 15% marginal tax rate. Beginning after the year 2000, **federal law** reduces these maximum capital gains rates for individuals to 18% (for those who would otherwise pay 20%) and 8% (for those who would otherwise pay 15%), provided the asset had been held more than five years.

Under **current state tax law**, capital gains for corporate and noncorporate taxpayers are taxed at the same rates as ordinary income, with no reduced capital gain rate (except that current PITL contains a 50% exclusion for gain recognized from the sale of qualified small business stock).

This bill would allow taxpayers a credit equal to 20% of the qualified value of real property donated to a city or county for open-space purposes.

"Qualified value" would mean the assessed value of the real property on the property tax roll for the year preceding the year of the donation.

No credit would be allowed unless the future use of the donated property is enforceably restricted for public use and enjoyment as open space or open area, as defined by Section 6954 of the Government Code¹.

The bill prevents taxpayers from claiming both a charitable contribution deduction and this credit for any property donation.

Any credit amount in excess of tax could be carried forward indefinitely.

Policy Considerations

This bill would raise the following policy considerations:

- ⌚ This bill would allow a tax credit for real property donated to a city or county even if the taxpayer were required to dedicate the land as open space (e.g., a developer required under development plans to dedicate land as open space).
- ⌚ Conflicting tax policies come into play whenever a credit is provided for an expense item for which preferential treatment is already allowed in the form of a deduction (providing a double benefit). Although this bill would eliminate the double benefit by preventing a taxpayer from claiming the charitable contribution deduction, this creates a state and federal difference that is contrary to the general policy of conformity. However, the elimination of the deduction would create a one-year, not an ongoing, difference.
- ⌚ This bill does not specify a repeal date or limit the number of years for the carryover. Credits typically are enacted with a repeal date to allow the Legislature to review their effectiveness. However, if an unlimited credit carryover were allowed, the department would be required to retain the carryover on the tax forms indefinitely. Recent credits have been enacted with a carryover limit since experience shows credits are typically used within eight years of being earned.

¹ Government Code Section 6954 defines "open space" or "open area" as any space or area characterized by (1) great natural scenic beauty or (2) whose existing openness, natural condition, or present state of use, if retained, would enhance the present or potential value of abutting or surrounding urban development, or would maintain or enhance the conservation of natural or scenic resources.

Implementation Considerations

This bill would raise the following implementation considerations. Department staff is available to help the author with any necessary amendments.

- Ⓟ The bill requires that the "future use of donated property is enforceably restricted for public use and enjoyment as open space or open area." It may be difficult for department staff to verify that the donated land is enforceably restricted as open space or open area. The author might consider having the local government that receives the donation certify that it meets this criterion. Further it is unclear what is intended by the term "future." If the author means the use of the property immediately after the contribution, the bill should be amended for clarity.
- Ⓟ Because of the term "future use," it is unclear whether a contribution of a future interest in real property would qualify for the credit proposed by this bill. It is also unclear whether a restriction (granted in perpetuity) on the use of real property or a remainder interest in real property would qualify for credit.
- Ⓟ It is unclear how to determine the credit amount if more than one taxpayer owns an interest in the same real property, or even if the credit is allowed. Would the credit be allowed if only one owner makes the contribution? Would the assessed value on the property tax rolls be allocated among the owners, or could the taxpayer making the donation claim the credit for the entire assessed value. If the donation consisted of a restriction or a remainder interest, would the credit be allowed? How would it be valued?

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department's costs.

Tax Revenue Estimate

This bill is estimated to impact PIT and B&CT revenue as shown in the following table. For this analysis, it was assumed that the property donated must be located in California.

Fiscal Year Cash Flow Impact Effective 1/1/2000 Enactment Assumed After June 30, 2000 \$ Millions			
Assumption	2000-01	2001-02	2002-03
\$25 Million In Donated Property	-\$3	-\$5	-\$5
\$50 Million In Donated Property	-\$7	-\$9	-\$9
\$100 Million In Donated Property	-\$13	-\$18	-\$18

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Tax Revenue Discussion

The revenue impact for this bill will be determined by assessed values of property that might be donated in any given year and the tax liabilities of donors for applying tax credits.

This estimate was developed in the following steps. First, three possible property value donation amounts were assumed \$100 million, \$50 million and \$25 million in qualified property for each fiscal year. Second, the credit will amount to 20% of these values. Third, it was assumed that contributors/donors would be able to apply 75% of the qualified credit amount per year, and the unapplied credits would be exhausted in the subsequent year. Revenue losses were adjusted to account for current law gains or contributions that would have otherwise been reported for the property.

BOARD POSITION

Pending.